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**NOTES TO THE FINANCIAL STATEMENTS**


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**NOTE 9: RETIREMENT PLANS**


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The State reports ten retirement plans as pension trust funds. This note describes the six defined benefit public employee retirement plans administered and contributed to by the State. The remaining plans, described in Note 10, are defined contribution plans administered by the State or a third party. The State may or may not make supplementary contributions to these plans. Although the assets of the six defined benefit plans are commingled for investment purposes, each plan's assets may be used only for payment of benefits to the members of that plan and for administrative costs, in accordance with the terms of the plan. The financial statements for these plans are presented in Note 13 of this *CAFR*. The State also provides an optional retirement plan for certain university employees and a special separation allowance for eligible sworn law enforcement officers.

**A. Plan Descriptions and Contribution Information**
**1. TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM**

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State, its component units, and local boards of education not in the reporting entity. Membership is comprised of employees of state agencies and institutions, local boards of education, universities and community colleges and certain proprietary component units. At June 30, 2002, the number of participating local boards of education and component unit employers was 197 as shown below:

Local boards of education .....	117
Community colleges .....	58
University of North Carolina System .....	17
Proprietary component units.....	5

Benefits and administrative expenses are funded by member contributions of 6% of compensation, investment income, and by a required employer contribution established by legislation. For the period July 1, 2001 through June 30, 2002, the actuarially based contribution of 1.97% of covered payroll was made to the plan. Benefit and contribution provisions are established by G.S. 135-5 and 135-8 and may be amended only by the North Carolina General Assembly.

During the 2001 fiscal year, the Governor, by executive order, reduced the required employer contributions to the plan by \$127 million for the purpose of balancing the state budget. Although no formal commitment has been made, legislative activity in the interim indicated these contributions will be made in the future if funding is available. The percentage of actual contributions made in relation to the required contributions for the State and its component units is shown in *Section D* of this note. All contributions, in relation to the plan

itself, are shown in the *Required Supplementary Information* section of this report.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

**2. CONSOLIDATED JUDICIAL RETIREMENT SYSTEM**

This plan is a single-employer, defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State Judicial System. Membership is comprised of judges, district attorneys and clerks of court. The plan provides retirement, disability and death benefits. Benefits and administrative expenses are funded by member contributions of 6% of compensation, investment income, and by employer contributions. For the period July 1, 2001 through June 30, 2002, the actuarially based required contribution of 14.05% of covered payroll was made to the plan. Benefit and contribution provisions are established by G.S. 135-57, 135-58, 135-68 and 135-69 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

**3. LEGISLATIVE RETIREMENT SYSTEM**

This plan is a single-employer, defined benefit plan established by the State of North Carolina to provide retirement and disability benefits for members of the General Assembly.

The benefit will not be payable while the member is employed in a position making him eligible to participate in either the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System or the Local Governmental Employees' Retirement System. Benefits and administrative expenses are funded by member contributions of 7% of compensation, investment income, and by employer contributions. For the period July 1, 2001 through June 30, 2002, the actuarially based required contribution was 23.94% of covered payroll. Legislation, however, established the contribution rate actually made of 23.20% of covered payroll. Benefit and actuarially based contribution provisions are established by G.S. 120-4.21, 120-4.19 and 120-4.20 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

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**NOTES TO THE FINANCIAL STATEMENTS***OTHER STATE ADMINISTERED SYSTEMS*

The State also administers the following pension and retirement plans for persons who are not considered employees of the State or its component units.

**4. FIREMEN'S AND RESCUE SQUAD WORKERS' PENSION FUND**

This plan is a defined benefit pension plan established by the State of North Carolina to provide pension benefits for all eligible firemen and rescue squad workers. Membership is composed of both volunteer and locally employed firemen and emergency medical personnel who elect membership. At June 30, 2002, there were 1,488 participating fire and rescue units. This is a special funding situation in that the State is not the employer but is legally obligated to contribute to the plan.

Benefits and administrative expenses are funded by a \$10 monthly contribution by the member, investment income and an actuarially based state appropriation. Benefit and contribution provisions are established by G.S. 58-86 and may be amended only by the North Carolina General Assembly.

**5. NATIONAL GUARD PENSION FUND**

This plan is a defined benefit plan established by the State of North Carolina to provide pension benefits for members of the North Carolina national guard. This is also a special funding situation, because the State is not the employer but is legally obligated to contribute to the plan.

For this fiscal year, the State did not make the full actuarially required contribution. Actual contributions made in relation to the required contributions for the State are shown in *Section D* of this note and in the *Required Supplementary Information* section of this report.

Benefits and administrative expenses are funded by an actuarially based state appropriation and investment income. Benefit and contribution provisions are established by G.S. 127(a)-40 and may be amended only by the North Carolina General Assembly.

**6. LOCAL GOVERNMENTAL EMPLOYEES' RETIREMENT SYSTEM**

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina for employees of local governments. Membership is comprised of general employees and local law enforcement officers of participating local governmental entities.

At June 30, 2002, the number of participating local governments was 885, as shown below:

Cities .....	407
Counties .....	100
Special districts .....	378

The plan provides retirement benefits nearly identical to the benefits that accrue to members of the Teachers' and State Employees' Retirement System. This plan also provides disability benefits for members who become totally and permanently disabled from performing their usual job. Benefits and administrative expenses are funded by employee contributions of 6% and actuarially based employer contributions. Employers contribute 5.27% of covered payroll for law enforcement officers and 4.80% for general employees and firemen for normal costs and an unfunded liability rate, which is established when the government initially enters the system. The State's responsibility is administrative only. Benefit and contribution provisions are established by G.S. 128-27 and 128-30 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains.

**NOTES TO THE FINANCIAL STATEMENTS**

The following table summarizes membership information by plan at the actuarial valuation date:

	<i>Teachers' and State Employees'</i>	<i>Judicial</i>	<i>Legislative</i>	<i>Firemen's, Rescue</i>	<i>National Guard</i>	<i>Local Govern- mental</i>
<b>Employee Groups</b>						
Retirees and beneficiaries currently receiving benefits .....	112,490	382	204	8,093	2,055	31,352
Terminated employees entitled to benefits but not yet receiving them .....	52,088	50	88	157	6,122	16,099
Active plan members .....	<u>297,252</u>	<u>487</u>	<u>169</u>	<u>30,514</u>	<u>7,460</u>	<u>118,580</u>
Total .....	<u>461,830</u>	<u>919</u>	<u>461</u>	<u>38,764</u>	<u>15,637</u>	<u>166,031</u>
Date of Valuation .....	12-31-01	12-31-01	12-31-01	6-30-01	12-31-01	12-31-01

## **B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PLAN ASSET MATTERS**

### *BASIS OF ACCOUNTING*

The financial statements of these plans are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

### *INVESTMENTS /SECURITIES LENDING*

Pursuant to North Carolina General Statutes, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains various investment portfolios in its Investment Pool. The investment balance of each system represents its share of the fair value of the net assets of the various portfolios within the pool. Additionally, the securities lending balance represents assets occurring from securities lending transactions resulting from the systems' participation in the pool.

No retirement system has investments in any single commercial or industrial organization whose fair value would amount to more than five percent of the system's net assets available for benefits.

## **C. Actuarial Methods and Assumptions**

The latest actuarial valuations are dated December 31, 2001 (June 30, 2001, for Firemen's and Rescue Squad Workers' Fund). The actuarial accrued liability and the schedule of funding progress are presented by system in the *Required Supplementary Information*. The actuarial value of assets for all systems is based on a five-year smoothed market value. Under this method, realized and unrealized gains and losses on investments are smoothed over five years. Below are listed the various actuarial methods and significant assumptions for these valuations that will be used to determine future annual required contributions.

<i>Retirement System</i>	<i>Valuation Date</i>	<i>Actuarial Cost Method</i>	<i>Amortization Method</i>	<i>Remaining Amortization Period</i>	<i>Period Open/Closed</i>	<i>Asset Valuation Method</i>	<i>Actuarial Assumptions</i>	
							<i>Investment Rate of Return</i>	<i>Projected Salary Increase</i>
<b>Teachers' and State Employees'</b>	12/31/01	Entry age	Level dollar	10 years	Open	5 year smoothed	7.25%	5.45-12.08%
<b>Consolidated Judicial</b>	12/31/01	Projected unit credit	Level percentage	9 years	Open	5 year smoothed	7.25%	5.63-12.58%
<b>Legislative</b>	12/31/01	Projected unit credit	Level dollar	8 years	Open	5 year smoothed	7.25%	7.50%
<b>Firemen's, Rescue Squad Workers'</b>	6/30/01	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	N/A
<b>National Guard</b>	12/31/01	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	N/A
<b>Local Governmental Employees'</b>	12/31/01	Frozen entry age	Level percentage	Various	Closed	5 year smoothed	7.25%	5.45-12.08%

N/A-Not applicable

## NOTES TO THE FINANCIAL STATEMENTS

The valuations for the Teachers' and State Employees' system, Local Governmental Employees' system, Legislative system, and Consolidated Judicial system reflect a 1.4% cost of living increase for retirees in these systems. In addition, the valuations for the Teachers' and State Employees' system and the Local Governmental Employees' system increased the benefit accrual rate from 1.81% to 1.82%. All of the benefit enhancements listed in this paragraph reflect legislation enacted by the North Carolina General Assembly and are effective July 1, 2002.

The projected investment returns and projected salaries for all systems, except the Legislative, include a 3.75% inflationary factor within the actuarial assumption. The assumption for the Legislative system does not identify an inflationary factor.

### CURRENT FISCAL YEAR ASSUMPTIONS

Unless otherwise noted in this footnote or in the required supplementary schedules, the actuarial values, methods and significant assumptions for the current year's required contributions are the same as those presented in the table shown on the prior page. The annual required contributions for the fiscal year ended June 30, 2002, were developed from various prior year valuations. The Teachers' and State Employees', Local Governmental Employees', Consolidated Judicial, and National Guard systems' valuations were as of December 31, 1999, the Legislative system was valued at December 31, 2000, and the Firemen's and Rescue Squad Worker's Fund was valued at June 30, 2000. These valuations used amortization periods of 9 years for Consolidated Judicial, 5 years for National Guard and 9 years

for the Firemen's and Rescue Squad Worker's Fund. The Teachers' and State Employees' system used the level percentage amortization method that produced a remaining amortization period of 23 years. The Local Governmental Employees' system is an aggregate of numerous employers, and consequently, has various amortization periods. The rate of investment return and projected salary increases used in these valuations assumed essentially the same increases as in the most current valuations reported on the prior page.

As a result of interim legislation, the December 31, 1999, actuarial value of assets for the Teachers' and State Employees' system was restated by the actuary from his original valuation. The system's actuarially required contributions for the fiscal year ended June 30, 2002, and its actuarial funding parameters were affected by these changes. The *Schedule of Funding Progress* presented in the *Required Supplementary Information* section of this report reflects adjustments for the impact of these changes on that valuation.

For the fiscal year ended June 30, 2002, the Local Governmental Employees' system provided a 3.7% cost of living increase for retirees and an increase in the benefit accrual rate from 1.78% to 1.81%. The Teachers' and State Employees' system, Legislative Retirement system and the Consolidated Judicial system provided a 2.0% cost of living increase for retirees in these systems. All of these benefit enhancements reflect legislation enacted by the North Carolina General Assembly and were effective July 1, 2001. These enhancements were either reflected as liabilities in the December 31, 2000 valuations or the systems will pay for them through actuarial gains.

## D. Annual Pension Cost and Net Pension Obligation

The annual pension costs and net pension obligations for the State's single-employer and special funding defined benefit plans for the current fiscal year are as follows:

	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund
Annual required contribution.....	\$ 7,003,000	\$ 858,357	\$ 10,026,897	\$ 1,542,443
Interest on net pension obligation.....	278,000	6,099	74,369	—
Adjustment to annual required contribution.....	(429,000)	(20,670)	(159,122)	—
Annual pension cost.....	6,852,000	843,786	9,942,144	1,542,443
Contributions made.....	8,493,000	964,825	10,026,897	899,758
Increase (decrease) in net pension obligation.....	(1,641,000)	(121,039)	(84,753)	642,685
Net pension (asset) obligation beginning of year....	3,832,000	84,128	1,025,780	—
Net pension (asset) obligation end of year.....	<u>\$ 2,191,000</u>	<u>\$ (36,911)</u>	<u>\$ 941,027</u>	<u>\$ 642,685</u>

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**NOTES TO THE FINANCIAL STATEMENTS**

The following table presents the required three year trend of pension costs for the State's single-employer and special funding defined benefit plans and the required contributions the State made to the Teachers' and State Employees' Retirement System (the System), a cost-sharing, multiple-employer plan. The State's contribution equals its pension expense/expenditures for the System. The State does not make any contributions to the Local Governmental Employees' System; therefore, it does not have any related pension cost.

**State of North Carolina's Annual Pension Cost (APC)  
and Annual Required Contributions (ARC) as an Employer**  
For the Years Ended June 30, 2000 through June 30, 2002 (in thousands)

	<b><i>Teachers' and State Employees'</i></b>		<b><i>Judicial</i></b>		<b><i>Legislative</i></b>		<b><i>Firemen's, Rescue</i></b>		<b><i>National Guard</i></b>
<b>Primary Government:</b>									
2002	\$ 50,835		\$ 6,852		\$ 844		\$ 9,942		\$ 1,542
2001	103,530 **		9,071		925		12,105		2,075
2000	197,480		8,435		889		12,105		2,545
<b>Component units:</b>									
<b>Universities:</b>									
2002	\$ 24,829								
2001	48,151 **								
2000	91,805								
<b>Community Colleges:</b>									
2002	\$ 9,676								
2001	19,489 **								
2000	35,746								
<b>Proprietary Funds:</b>									
2002	\$ 333								
2001	704 **								
2000	1,250								
<b>Total Primary Government and Component Units:</b>									
2002	\$ 85,673		\$ 6,852		\$ 844		\$ 9,942		\$ 1,542
2001	171,874 **		9,071		925		12,105		2,075
2000	326,281		8,435		889		12,105		2,545
<b>Percentage of APC Contributed:</b>									
2002			124%		114%		101%		58%
2001			58%		51%		92%		100%
2000			100%		91%		100%		100%
<b>Percentage of ARC Contributed:</b>									
2002	100%								
2001	100%								
2000	100%								
<b>Net Pension (Asset) Obligation:</b>									
2002		\$ 2,191		\$ (37)		\$ 941		\$ 643	
2001		3,832		84		1,026		—	
2000		—		(369)		—		—	

\*\* The State's contributions/pension costs for 2001, as reported in the 2001 CAFR, are restated here to reflect contributions/pension cost adjustments.

Yearly pension liabilities for the systems are shown in the *Required Supplementary* section of this report. Beginning with the accounting transition year of 1997, liabilities were determined in accordance with Governmental Accounting Standards Board Statement No. 27 (GASB 27). As presented here, each system's yearly APC and net pension (asset) obligation were computed retroactively to 1993 in accordance with GASB 27 and contain the cumulative effect of applying that statement.

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**NOTES TO THE FINANCIAL STATEMENTS****E. Optional Retirement Plan**

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Faculty and administrators with faculty rank in universities of the UNC System may join the Program instead of the Teachers' and State Employees' Retirement System. At June 30, 2002, the Plan had 8,822 participants.

Benefits are provided by means of contracts issued and administered by the privately-operated Teachers' Insurance and Annuity Association and the College Retirement Equities Fund (TIAA/CREF), Valid, Fidelity Investments and Lincoln National Life Insurance Company. Participants' eligibility and contributory requirements are established in G.S. 135-5.1. Participants contribute 6% of compensation and the university contributes 6.84%. There is no liability other than the universities' required contributions. The universities contributed \$49,747,040 for the 2001-02 fiscal year. Annual covered payroll was \$727,295,903 and employer contributions expressed as a percentage of annual covered payroll were 6.84% for the fiscal year ended June 30, 2002. Employee contributions expressed as a percentage of annual covered payroll were 6%, with an actual employee contribution of \$43,637,754 for the 2001-02 fiscal year.

Participants are vested after five years of service, but the company must return the value of the universities' contributions to the State if termination occurs prior to five years of service. The participant chooses his/her own investment products with the company of choice.

**F. Special Separation Allowance**

The State provides a special separation allowance (SSA), an agent multiple-employer, defined benefit pension plan, for sworn law enforcement officers as defined by G.S. 135-1(11b) or G.S. 143-166.30(a)(4) that were employed by State agencies and component units and retired on a basic service retirement under the provisions of G.S. 135-5(a). To qualify for the allowance, each retired officer must: (1) have completed 30 or more years of creditable service or have attained 55 years of age and completed five or more years of creditable service; and (2) not have attained 62 years of age; and (3) have completed at least five years of continuous service as a law enforcement officer immediately preceding a service retirement. Each eligible officer is paid an annual separation allowance equal to .85% of the officer's most recent base rate of compensation for each year of creditable service. For the fiscal year ended June 30, 2002, the State and its component units paid \$ 9,437,531 for 722 retired law enforcement officers. These benefits are funded on a pay-as-you-go basis with each employer (the State or component unit) responsible for the benefits to their former employees. There is no statewide administration of the SSA and there is no actuarial valuation performed. Funds for this allowance are appropriated annually in the budget of each state agency or paid from the component unit's operations for those employers who have eligible, retired law enforcement officers. These benefits are established in G.S. 143-166.41 and may be amended only by the General Assembly.